DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 02-20100173
Income Tax
For Tax Years 2000-07

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ISSUES

I. Adjusted Gross Income Tax–Throwback Sales.

Authority: Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992); Indiana Dep't. of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981); 15 U.S.C. § 381; IC § 6-3-2-2; IC § 6-8.1-5-1; 45 IAC 3.1-1-38; 45 IAC 3.1-1-53; 45 IAC 3.1-1-64.

Taxpayer protests the inclusion of throwback sales in the Department's Indiana adjusted gross income tax calculations.

II. Tax Administration–Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a corporation headquartered in Indiana. The Indiana Department of Revenue conducted an audit of the tax years 2006 and 2007. Due to Net Operating Loss ("NOL") calculations, and the impact of this audit on those figures, the audit also included calculations for that issue for the years 2000 through 2007. The only years to result in assessment were 2006 and 2007, which were the years under audit. The Department concluded that Taxpayer had not provided sufficient supporting documentation to verify that its activities in states other than Indiana subjected Taxpayer to net income taxes in those states. The Department therefore considered all of Taxpayer's income to be subject to Indiana adjusted gross income tax ("AGIT") and issued proposed assessments for AGIT, ten percent negligence penalty, and interest. Taxpayer protests that its activities in the other states did exceed mere solicitation of sales and that the income in question should be allocated to those other states. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Adjusted Gross Income Tax–Throwback Sales.

DISCUSSION

Taxpayer protests the Department's decision to subject Taxpayer's income from sales to customers in other states to the "Throwback" rule. Taxpayer states that its activities in those states do exceed the protection of P.L. 86-272 and so provide sufficient nexus with those states to subject it to net income taxes in those states. Therefore, Taxpayer believes that the income from those sales should not be subject to the throwback rule and that it should not be subject to additional Indiana AGIT. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The adjusted gross income tax is imposed under IC § 6-3-2-2, which states in relevant parts:

(a) With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

(1) income from real or tangible personal property located in this state;
(2) income from doing business in this state;
(3) income from a trade or profession conducted in this state;
(4) compensation for labor or services rendered within this state; and
(5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources within Indiana. In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana. In the case of compensation of a team member (as defined in section 2.7 of this chapter) only the portion of income determined to be Indiana income under section 2.7 of this chapter is considered derived from sources within Indiana. In the case of a corporation that is a life insurance company (as defined in Section 816(a) of the Internal Revenue Code) or an insurance company that is subject to tax under Section 831 of the Internal Revenue Code, only so much of the income as is apportioned to Indiana under subsection (r) is considered derived from sources within Indiana.

. . .

(e) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. Sales include receipts from intangible property and receipts from the sale or exchange of intangible property. However, with respect to a foreign corporation, the denominator does not include sales made in a place that is outside the United States. Receipts from intangible personal property are derived from sources within Indiana if the receipts from the intangible personal property are attributable to Indiana under section 2.2 of this chapter. Regardless of the f.o.b. point or other conditions of the sale, sales of tangible personal property are in this state if:

(1) the property is delivered or shipped to a purchaser that is within Indiana, other than the United States government; or

(2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and:

(A) the purchaser is the United States government; or

(B) the taxpayer is not taxable in the state of the purchaser.

Gross receipts derived from commercial printing as described in IC 6-2.5-1-10 shall be treated as sales of tangible personal property for purposes of this chapter.

. . .

(n) For purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if:

(1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or

(2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

. . ..

45 IAC 3.1-1-53 states:

Gross receipts from the sales of tangible personal property (except sales to the United States Government–See Regulation 6-3-2-2(e)(050) [45 IAC 3.1-1-54] are in this state: (a) if the property is delivered or shipped to a purchaser within this state regardless of the F.O.B. point or other conditions of sales; or (b) if the property is shipped from an office, store, factory, or other place of storage in this state, and the taxpayer is not taxable in the state of the purchaser. See Regulation 6-3-2-2(n)(010) [45 IAC 3.1-1-64].

Examples:

. . .

(5) If the taxpayer is not taxable in the state of the purchaser, the sale is attributed to this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state. Such sale is termed a "Throwback" sale. Example: The taxpayer has its head office and factory in State A. It maintains a branch office and inventory in Indiana. Taxpayer's only activity in State B is the solicitation of orders by a resident salesman. All orders by the State B salesman are sent to the branch office in Indiana for approval and are filled by shipment from the inventory in Indiana. Since the taxpayer is immune under P.L.86-272 from tax in State B, all sales of merchandise to purchasers in State B are attributed to Indiana, the state from which the merchandise was shipped.

. . ..

(Emphasis added.)

45 IAC 3.1-1-38 provides:

For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such state including, but not limited to:

(1) Maintenance of an office or other place of business in the state

(2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods

(3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution

(4) Rendering services to customers in the state

(5) Ownership, rental or operation of a business or of property (real or personal) in the state

(6) Acceptance of orders in the state

(7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L.86-272 to tax its net income.

As stated in Regulation 6-3-2-2(b)(010) [45 IAC 3.1-1-37], corporations doing business in Indiana as well as other states are subject to the allocation and apportionment provisions of IC 6-3-2-2(b)-(n).

(Emphasis added.)

45 IAC 3.1-1-64 states:

A corporation is "taxable in another state" under the Act when such state has jurisdiction to subject it to a net

income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. §381-385. In the case of any "State," as defined in IC 6-3-1-25, other than a state of the United States or political subdivision of such state, the determination of whether such "state" has jurisdiction to subject the taxpayer to a net income tax shall be made by application of the jurisdictional standards applicable to that state of the United States. If jurisdiction to tax is otherwise present, such "state" is not considered as being without jurisdiction to tax by reason of the provisions of a treaty between that state and the United States.

Example:

Corporation X is actively engaged in manufacturing farm equipment in State A and foreign country B. Both State A and foreign country B impose a net income tax but foreign country B exempts corporations engaged in manufacturing farm equipment. Corporation X is subject to the jurisdiction of State A and foreign country B.

Taxpayers are not subject to throwback on sales into states in which they are taxable under this regulation [45 IAC 3.1-1-64]. See Regulation 6-3-2-2(e)(040) [45 IAC 3.1-1-53].

(Emphasis added.)

The Indiana Supreme Court explained in Indiana Dep't. of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981):

Public Law 86-272 (15 U.S.C.A. § 381), in pertinent part is as follows:

(a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)

Id. at 1265.

The Court then explained:

We also believe that Congress perceived "solicitation" as embodying "sundry activities so long as those activities [are] closely related to the eventual sale of a product." Finally, when a corporate representative performs an "act of courtesy" in order to accommodate a customer, he has not ventured beyond the realm of "solicitation."

Id. at 1268.

The United States Supreme Court explained its standard for determining "solicitation of sales" in Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992). In Wrigley, the Court explained:

We proceed, therefore, to describe what we think the proper standard to be. Once it is acknowledged, as we have concluded it must be, that "solicitation of orders" covers more than what is strictly essential to making requests for purchases, the next (and perhaps the only other) clear line is the one between those activities that are entirely ancillary to requests for purchases -- those that serve no independent business function apart from their connection to the soliciting of orders -- and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force. National Tires, Inc. v. Lindley, 68 Ohio App. 2d 71, 78-79 426 N.E.2d 793, 798 (1980) (company's activities went beyond solicitation to "functions more commonly related to maintaining an on-going business"). Providing a car and a stock of free samples to salesmen is part of the "solicitation of orders," because the only reason to do it is to facilitate requests for purchases. Contrariwise, employing salesmen to repair or service the company's products is not part of the "solicitation of orders," since there is good reason to get that done whether or not the company has a sales force. Repair and servicing may help to increase purchases; but it is not ancillary to requesting purchases, and cannot be converted into "solicitation" by merely being assigned to salesmen. See, e. g., Herff Jones Co. v. State Tax Comm'n, 247 Ore. 404, 412, 430 P.2d 998, 1001-1002 (1967) (no § 381 immunity for sales representatives' collection activities).

Id, at 228-30.

The Court further explained:

By contrast, Wrigley's in-state recruitment, training, and evaluation of sales representatives and its use of hotels and homes for sales-related meetings served no purpose apart from their role in facilitating solicitation. The same must be said of the instances in which Wrigley's regional sales manager contacted the Chicago office about "rather nasty" credit disputes involving important accounts in order to "get the account and [Wrigley's] credit department communicating." App. 71, 72. It hardly appears likely that this mediating function

between the customer and the central office would have been performed by some other employee -- some company ombudsman, so to speak -- if the on-location sales staff did not exist. The purpose of the activity, in other words, was to ingratiate the salesman with the customer, thereby facilitating requests for purchases. Finally, Wrigley argues that the various nonimmune activities, considered singly or together, are de minimis. In particular, Wrigley emphasizes that the gum sales through "agency stock checks" accounted for only 0.00007 [percent] of Wrigley's annual Wisconsin sales, and in absolute terms amounted to only several hundred dollars a year. We need not decide whether any of the nonimmune activities was de minimis in isolation; taken together, they clearly are not. Wrigley's sales representatives exchanged stale gum, as a matter of regular company policy, on a continuing basis, and Wrigley maintained a stock of gum worth several thousand dollars in the State for this purpose, as well as for the less frequently pursued (but equally unprotected) purpose of selling gum through "agency stock checks." Although the relative magnitude of these activities was not large compared to Wrigley's other operations in Wisconsin, we have little difficulty concluding that they constituted a nontrivial additional connection with the State. Because Wrigley's business activities within Wisconsin were not limited to those specified in § 381, the prohibition on net-income taxation contained in that provision was inapplicable.

Id. at 234-5.

Therefore, the Department may look at a taxpayer's Indiana activities as a whole to determine if the activities as a whole exceed the protection of Public Law 86-272.

As explained in the audit report, Taxpayer did not provide sufficient documentation to establish that its non-solicitation activities in the other states rose above the de minimis level. The Department was left with no choice but to determine that those activities were de minimis and that Taxpayer was not subject to net income taxes in any state other than Indiana. As a result of the protest process Taxpayer was able to provide additional documentation and analysis, which the Department's research substantiated, supporting its position that its employees performed sufficient non-solicitation activities in the states where it had sales to rise above the de minimis level and so to subject it to net income taxes in those states, as provided by Wrigley.

Since Taxpayer was taxable in the other states, the throwback rule provided by 45 IAC 3.1-1-53 does not apply in this case. Taxpayer is sustained on its protest of the additional AGIT assessments. Also, the audit's NOL calculations are unnecessary and moot. However, the Department strongly encourages Taxpayer to exercise increased vigilance in its record-keeping and to keep such records readily available for Departmental review. This will reduce the likelihood of requiring both parties to incur the time and effort of participating in the protest process in the event of a future audit.

FINDING

Taxpayer's protest is sustained.

II. Tax Administration–Negligence Penalty.

DISCUSSION

Taxpayer protests the imposition of ten percent negligence penalty. Taxpayer states that it correctly reported Indiana income tax for the years 2006 and 2007.

The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

. . .

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

. . .

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer has been sustained on the underlying tax discussed above in Issue I. Since Taxpayer has been sustained, and since there are no other issues or liabilities upon which to impose penalty, Taxpayer has demonstrated that it was not negligent in its tax duties.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer is sustained on Issue I regarding adjusted gross income tax. Taxpayer is sustained on Issue II regarding negligence penalty.

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